



Treasury Inspector General for Tax Administration

TAX-EXEMPT HOSPITAL INDUSTRY COMPLIANCE WITH COMMUNITY BENEFIT AND COMPENSATION PRACTICES IS BEING STUDIED, BUT FURTHER ANALYSES ARE NEEDED TO ADDRESS ANY NONCOMPLIANCE

Issued on March 29, 2007

Highlights

Highlights of Report Number: 2007-10-061 to the Internal Revenue Service Commissioner for the Tax Exempt and Government Entities Division.

IMPACT ON TAXPAYERS

According to the Congressional Budget Office, nonprofit hospitals received more than \$6 billion in Federal tax exemptions in 2002. The Exempt Organizations (EO) function of the Tax Exempt and Government Entities Division is responsible for ensuring organizations exempt from Federal income tax comply with applicable Internal Revenue Code sections and regulations. EO function management is conducting a project to assess how tax-exempt hospitals believe they provide a community benefit in exchange for tax-favored status. Management stated that project information may assist them in differentiating tax-exempt hospitals from for-profit hospitals and could result in regulatory changes or a Revenue Ruling.

WHY TIGTA DID THE AUDIT

The more recent of the 2 most significant Revenue Rulings related to tax-exempt hospitals was issued by the Internal Revenue Service (IRS) almost 40 years ago. The Government Accountability Office has stated there is often little to no difference between for-profit and tax-exempt hospitals when it comes to charity care and community benefits provided. The IRS Commissioner has commented that some tax-exempt health care providers may not differ markedly from for-profit providers in their operations, their attention to the benefit of the community, or their levels of charity care. Also, both the Senate Finance Committee and the House Ways and Means Committee have voiced concerns related to whether taxpayers receive a public benefit in exchange for the billions of dollars of tax subsidies received by tax-exempt hospitals each year. The objective of our audit was to determine the purpose and scope of the EO function's tax-exempt hospital compliance project and how management intends to

use the results to address potential noncompliance in the industry.

WHAT TIGTA FOUND

As part of this compliance project, the IRS sent a 9-page questionnaire to 544 tax-exempt hospitals soliciting information on compensation practices and the community benefit standard. At the time of our fieldwork, the EO function was still analyzing the questionnaire responses and identifying potential examinations of organizations based on the manner in which executive compensation was determined. If information gathered in the compliance project shows hospitals are performing only minimum actions in exchange for exemption from paying taxes, the function will consider initiating examinations in this area. Management stated that project information also may assist them in differentiating tax-exempt hospitals from for-profit hospitals and in determining whether legislative action would improve the IRS' ability to administer tax laws in the tax-exempt hospital industry. Additionally, the compliance project will gather information about the practices and procedures tax-exempt organizations use to assign compensation to executives and other outsiders and enhance compliance in this area, if necessary. When the analyses are completed, management will prepare two reports (interim and final) summarizing the results of the analyses of the questionnaires and related examinations.

WHAT TIGTA RECOMMENDED

TIGTA recommended the Director, EO, ensure the interim report includes an assessment of how tax-exempt hospitals are providing a community benefit (in exchange for exemption from paying taxes), as well as any planned actions management determines are necessary to address the community benefit standard. In addition, management should develop plans to prepare a separate final report on community benefit if all necessary actions will not be completed for inclusion in the final compliance report scheduled for issuance in September 2008.

In their response to the report, IRS officials stated they generally agreed with the recommendation. Specifically, IRS officials stated the interim report will contain the above detailed community benefit information pertaining to tax-exempt hospitals. IRS officials also stated it is too early in the process to determine if a supplemental report on community benefit is needed or what the precise next steps will be, but agreed to issue such a report if they determine it is necessary.

READ THE FULL REPORT

To view the report, including the scope, methodology, and full IRS response, go to

<http://www.treas.gov/tigta/auditreports/2007reports/200710061fr.pdf>.

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